Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	**EB Docket No. 03-200**
Section 272(d) Biennial Audit of	)	
Verizon Communications, Inc.	)	

COMMENTS OF AT&T CORP. ON VERIZON'S SECOND SECTION 272 COMPLIANCE BIENNIAL AUDIT REPORT

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Pursuant to the Commission's December 5, 2003 Memorandum Opinion and Order in the above entitled matter,[1] AT&T Corp. ("AT&T") hereby submits its Comments on the Report of PricewaterhouseCoopers LLP (the "Auditor") filed on December 12, 2003 in connection with the second biennial Section 272 audit of the Verizon companies ("Auditor's Report").

INTRODUCTION AND SUMMARY

The *General Standard Procedures for Biennial Audits Required Under Section 272 of the Communications Act of 1934, As Amended* ("*General Standard Procedures*") used for this Audit[2] were woefully inadequate, even less rigorous than those used in the prior audit, failing to conduct the proper inquiries and gather the evidence necessary to fully test Verizon's compliance with the key Section 272 requirements. Thus, even if the Auditor's Report here had given Verizon a clean bill of health, there would be no possible basis to conclude that Verizon complied with its Section 272 obligations during the audit period.

[1] Memorandum Opinion and Order, *In re Verizon Communications, Inc.*, EB File No. EB-03-IH-0341, 2003 WL 22870323 (rel. December 5, 2003) (*Verizon Second Disclosure Order*) ¶ 21.

[2] Appended to the Auditor's Report as Attachment D.

But the Auditor's Report does not give Verizon a clean bill of health. To the contrary, even the limited data provided demonstrate pervasive discrimination and anticompetitive conduct in clear violation of Section 272. For example, with regard to DS-1 service in New York and Massachusetts, Verizon's Section 272 affiliate consistently received better performance for installation and repair than unaffiliated carriers. The Auditor's Report likewise details numerous violations by Verizon of its Section 272 obligations to, *inter alia*, operate independently from its affiliates (including clear violations of the Operation, Installation and Maintenance or "OI&M" safeguard), to keep separate books, records and accounts, to maintain separate employees, and to conduct affiliate transactions on an arms-length basis. Despite gaps that would preclude a finding of compliance, the information unearthed regarding Verizon's practices is sufficiently egregious to require the Commission to impose a substantial remedy and penalty.

The experience with this, and the prior Auditor's Reports, also undercuts the BOCs' assertions that the Section 272 structural safeguards are unnecessary because the Section 272 biennial audit effectively detects and deters the cost misallocation and discrimination that the Section 272 safeguards were designed to prevent.[3] To the contrary, the section 272 biennial audit is virtually useless as a detection and deterrence tool.

First and foremost, the process for developing the *General Standard Procedures* allow the BOC to tailor the audit so as to avoid the detection of cost misallocation or discriminatory conduct. The BOC negotiates the *General Standard Procedures* for each audit without any input from the unaffiliated competitive carriers directly harmed by the discriminatory conduct or from

[3] *See, e.g.,* Verizon OI&M Forbearance Petition, CC Docket No. 96-149 (Aug. 5, 2002) at 9; *Notice Of Proposed Rulemaking*, Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates, WC Docket No. 03-228, FCC 03-272 (rel. November 4, 2003) ¶¶ 9-10 (seeking comment on the effectiveness of non-structural safeguards alone) and Comments of Verizon, WC Docket No. 03-228 (December 10, 2003) at 12 and note 16.

the public at large.[4] The BOC accordingly can tailor the procedures to avoid any analysis of conduct that might violate Section 272. Because unaffiliated carriers are barred from participation in this process, the Auditor lacks any access to the details of discrimination endured by these carriers – details that might well evidence a broader pattern of discrimination. The result is that the most likely areas of discrimination are simply not audited at all, or the Auditor merely relies on representations by Management without the ability to demand and review underlying documentation.

This is precisely what occurred here. The *General Standard Procedures* used in this Audit eliminated procedures and documentation requirements that in the first audit identified violations (such as whether the bonuses of officers, directors and employees were dependent upon the performance of the affiliated company). Not only does this defeat Congress' intent that the audit gather all the evidence necessary to test fully Verizon's compliance with the key Section 272 requirements, but by allowing the BOC to individually tailor and control the scope of its own audit, it also undermines public confidence in the Commission's auditing processes.

Second, the process continues to be subject to inexcusable delay. The audit period for Verizon ended in December *2002.* Despite the Commission's clear ruling in the prior audit

[4] As more fully explained in AT&T's Comments on Verizon's First Biennial Report, CC Docket No. 96-150 (April 8, 2002) at 11, the *General Standard Procedures* are far weaker than the proposed model audit requirements which were the subject of a public notice issued by the Commission in 1977, Public Notice, 12 FCC Rcd. 13132A (1997), but never acted on by the Commission. The Proposed Model would also have had the virtue of uniformity of auditing procedures between the BOCs, allowing for more meaningful "benchmarking." Memorandum Opinion And Order, *Applications Of Ameritech Corp., Transferor, And SBC Communications Inc., Transferee, For Consent To Transfer Control Of Corporations,* 14 FCC Rcd. 14712 (1999) ("*Ameritech-SBC Merger Order*") ¶ 106 ("For regulators and competitors, comparative analyses of the practices and approaches of a variety of similarly situated incumbent LECs can render valuable information regarding network features, capabilities and costs"*);* Memorandum Opinion And Order, *Application Of GTE Corp., Transferor, And Bell Atlantic Corp., Transferee, For Consent To Transfer Control,* 15 FCC Rcd. 14032 (2000) ("*Bell Atlantic – GTE Merger Order*") ¶ 133.

proceeding that an unredacted Audit Report must be filed,[5] Verizon submitted a redacted audit report in June 2003, deleting all of the critical performance measurement data. Although ordered by the Bureau to file an unredacted version in early August, Verizon failed to do so until a year after the audit period ended, and only after its frivolous appeal of the Bureau's decision to the Commission was dismissed.[6]

Finally, the Commission has failed to take seriously the Section 272 violations uncovered by the prior audit. As a result of the violations identified in the first Section 272 audit of Verizon, the Commission issued an NAL that *accepted* Verizon's efforts to evade the performance metrics by unilaterally substituting patently inadequate measurements likely to miss or mask discrimination, *sanctioned* Verizon's delaying tactics by dismissing other violations because the statute of limitations had run, and then imposed nominal penalties for the remaining section 272 violations.[7]

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[5] Memorandum Opinion and Order, *In the Matter of Accounting Safeguards Under the Telecommunications Act of 1996: Section 272(d) Biennial Audit Procedures*, CC Docket No. 96-150, 17 FCC Rcd. 1374 ("*First Verizon Disclosure Order*") *recon. denied*, Order on Reconsideration, 17 FCC Rcd. 6955 (2002) ("*Verizon Reconsideration Order*").

[6] *Verizon Second Disclosure Order, supra* note 1.

[7] *In the Matter of Verizon Telephone Companies, Inc. Apparent Liability for Forfeiture*, File No. EB-03-IH-0245 (rel. Sept. 8, 2003). There, the Commission found that the Section 272 biennial audit showed that "Verizon failed to record a total of 43 transactions [out of 70 sampled] according to the methods specified in section 32.27" so that "Verizon has apparently failed to justify its accounting entries for approximately $16 million in services provided to its section 272 affiliate;" *id*, ¶ 13 and imposed a fine of $283,000. *Id.* ¶ 17. For the Internet posting violations, "because we are barred by the one year statute of limitations" all the Commission could do was "admnish the company." *Id.* ¶ 13. Finally, although the audit guidelines required disaggregation of services for the purpose of measuring performance, Verizon unilaterally induced the auditor to adopt measurements that did not disaggregate the data (*see* AT&T Comments on the First Biennial Audit at 16-22) "to a level sufficient to permit a service-by-service discrimination analysis." The Commission, accordingly, declined to find any violation. *Id.* ¶ 16, n.18.

ARGUMENT

The *General Standard Procedures* used in this proceeding are even weaker than those used in the prior Verizon Audit. Gone, for example, is the requirement that the Auditor, in auditing compliance with the "separate officers, directors, and employees" requirement, inquire as to whether the calculation of the annual bonuses for the 217 overlapping employees or the overlapping officer and director was tied to the performance of the BOC, or the combined performance of the BOC and the Section 272 affiliate, even though that was found in the prior audit. Other deficiencies in the Auditor's Report make it impossible to ascertain whether or not other violations occurred. The Auditor's Report, for example, does not disclose the identity of the "third party vendors" providing OI&M services or the specific services provided by these "third parties." The Auditor's Report also reported that Verizon often failed to keep the data required under the *General Standard Procedures* to ascertain compliance.

Despite these deficiencies, the Auditor's Report nevertheless identified violations of the structural, transactional and anti-discrimination safeguards. The Auditor found persistent discrimination in the installation and maintenance of DS-1 service in New York and Massachusetts that cannot be explained away as simply the result of different choices made by the affiliated and unaffiliated carriers. The Auditor's Report also identified violations of the OI&M and joint ownership safeguards as well as a likely violation of the prohibition against overlapping officers and directors. Finally, the Auditor's Report found an overwhelming number of violations of the transactional rules by, for example, the provisioning services to the Section 272 affiliates prior to the execution of a written agreement or amendment, failing to post agreements on the web in a timely and complete manner and failing to make these agreements available for public inspection. Verizon's repeated mantra of "administrative" or "human" error rings hollow and is simply not credible.

I. EVEN THE INCOMPLETE DATA PROVIDED IN THE AUDITOR'S REPORT DEMONSTRATE PERVASIVE DISCRIMINATION FAVORING THE SECTION 272 AFFILIATE IN PERFORMANCE METRICS AND IN THE PROVISION OF GOODS AND SERVICES

A. The Performance Measures Used In The Audits Show Discrimination In Providing Special Access Services Used To Provide InterLATA Services

Under Section 272(e)(1), a BOC must "fulfill" all "requests" by competing carriers for "exchange access" and other services under the same time standards that it provides to its Section 272 affiliates. In interpreting this vital nondiscrimination obligation, the Commission concluded that "the term 'requests' should be interpreted broadly" to include, at a minimum, "initial installation requests, subsequent requests for improvement, upgrades or modifications of service, or repair and maintenance of these services." *Non-Accounting Safeguards Order* ¶ 239. For these and any other "equivalent requests," the Commission's rules require that "the response time a BOC provides to unaffiliated entities should be no greater than the response time it provides to itself or its affiliates." *Id.* ¶ 240.

In the prior Verizon Section 272 audit, AT&T noted the deficiencies in the performance metrics used in the *General Standard Procedures* (although not applied in that audit) and proposed that the Joint Competitive Industry Group Proposal Regarding Performance Metrics and Installation Intervals for Interstate Special Access Services submitted in the *Special Access Docket*[8] would be a more useful set of metrics.[9] AT&T also noted the Auditor's failure to measure persistent discrimination by Verizon between special access services provided by the

[8] CC Docket No. 01-321.

[9] *Ex parte* Letter of Patrick Merrick, AT&T, to Marlene Dortch, FCC, May 9, 2002, CC Docket No. 96-150 at 2.

BOC "to itself", *i.e.*, special access services that the BOC has provided directly to "retail" customers, versus that provided on a wholesale basis.[10] These same deficiencies exist here.

Nevertheless, the performance data provided in the Auditor's Report indicate that the Section 272 affiliates received preferential treatment over unaffiliated carriers.[11] As explained more fully in the attached Declaration of statistician Dr. Robert Bell,[12] the Firm Order Confirmation Response Time ("FOC") and "Average Installation" intervals for DS-1 service in New York and Massachusetts were, for unaffiliated carriers, consistently and materially longer than for the 272 affiliate.[13] Bell Decl. ¶¶ 6-9. Non-affiliates similarly received poorer repair service for DS-1 (in New York) and FG-D service (in Massachusetts) than the section 272 affiliates.[14] Bell Decl. ¶ 10.

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[10] *Id., see also* WorldCom's Comments on Verizon's First Biennial Audit (April 8, 2002) at 7-9.

[11] Objective VIII, Procedure 4 and Attachment A. Verizon utilized "the methods used to prepare the BA/GTE Merger Order reports [Condition XIX] ... to provide these same metrics for the special access services" herein. Objective VIII, Procedure 3, Appendix A:65. *See also*, Procedure 4, A:66 (because Merger Conditions were used, the business rules applied are not fully consistent with the affidavits filed in New York, Massachusetts and Connecticut). Moreover, the comparison is actually only between VLD and "the top six nonaffiliate long distance carriers." *Id.* A:67-68.

[12] Attachment 1 hereto.

[13] For FOC intervals, *see* Attachment A-35 to A-36 (New York); A-15 to A-16 (Massachusetts). For Average Installation intervals, *see* A-37 and A-39 (New York); A-17 and A-19 (Massachusetts). The data for New Jersey and Rhode Island showed a similar trend. For New Jersey, *see* A:30 (FOC intervals) and A:31 (Average Installation intervals); for Rhode Island *see* A:65 (FOC intervals) and A:66 (Average Installation intervals). The percent of access services installed on time ("Percent Met") data also showed a preference for the 272 affiliate over unaffiliated carriers. *Id.* A-38 and A-40 (New York); A-18 and A-20 (Massachusetts); A-32 (New Jersey); *see also*, A-67 (Rhode Island).

[14] *Id.* A-41 and A-42 (New York); A-21 to A-22 (Massachusetts). Indeed, as Dr. Bell notes, the data may understate the differential inasmuch as Verizon excluded "trouble" data that should have been included under the business rules Verizon used. Appendix A:77; Bell Decl. ¶ 10. PIC Interval data also show a consistent and material trend of preferential treatment for the 272 affiliate. Attachment A-43 to A-44 (New York, consistently in 2001 and the first quarter of 2002); A-23 to A-24 (Massachusetts, consistently in 2001 and the first quarter of 2002). *see also*

Verizon does not contest that the performance data show a marked preference for its Section 272 affiliate. Instead Verizon tries to explain it away. Verizon alleges that for Special Access and Feature Group D results, installations took longer, not because of discrimination but purportedly because unaffiliated carriers: (1) tended to request installation dates that were longer than the standard interval; (2) required building of facilities more often than affiliated carriers (because unaffiliated carriers tended to purchase special access on both high density and less dense routes while the 272 affiliates focused only on the former); and (3) orders involved copper facilities rather than fiber orders.[15] The fiber versus copper difference also allegedly explained the differences in maintenance data (because trouble incidents are typically less frequent and can be restored more quickly on fiber).[16]

However, as Dr. Bell points out, there are numerous defects with the "studies" purportedly supporting Verizon's justifications. There are evident procedural deficiencies. Verizon does not disclose the sampling technique (including how the states, carriers and time periods sampled were selected). Bell Decl. ¶ 14. Nor did an independent third party such as the Auditor conduct these studies. *Id.*

More importantly, the studies are incomplete and do not fully explain the observed differential. For example, as Dr. Bell explains, without empirical evidence about the magnitude of the delay associated with requested due dates beyond the standard minimum, Verizon's

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A-53 to A-54 (Pennsylvania (BA), same). Finally, although under Section 272(e)(1), the BOC must also "make available to unaffiliated entities information regarding the service intervals in which the BOCs provide service to themselves or their affiliates," *Non-Accounting Safeguards Order* ¶ 242, Verizon "indicated that it does not routinely make available to unaffiliated entities information on service intervals in providing service to Section 272 affiliates, other affiliates and non-affiliates." Appendix A:81, Objective VIII, Procedure 6.

[15] Appendix A:71-A:73.

[16] *Id.* A:73-A:75.

analysis provides no evidence that this factor explains a substantial portion – much less all – of the large difference between the average installation times for non-affiliates versus affiliates. Bell Decl. ¶ 16. Nor does Verizon provide any empirical evidence as to how many of the extended date requests are due to the reasons it identifies. Verizon asserts no more than that "it has reason to believe" that customers "sometimes" seek extended requested due dates because of their need to construct facilities.[17] But extended date requests may also be due to Verizon's own requirements or practices, *e.g.*, Verizon's requirement that unaffiliated carriers include additional days on the Access Service Request ("ASR") where nine or more circuits are ordered to the same location.[18] The question of whether the differential shown by the data in the Auditor's Report reflects improper discrimination *vel non* could have been addressed directly by comparing non-affiliate installation times with those for affiliates, restricted to orders where the customer did not request an extension to the due date. *Id.*

The same deficiencies exist with respect to Verizon's fiber versus copper comparison. Bell Decl. ¶ 17. Verizon again failed to provide any empirical data on how much longer it takes to provision or repair copper as compared to fiber. Nor did Verizon make a "like-to-like" comparison between affiliated and unaffiliated carriers as to the installation and repair of fiber facilities although it had the data to do so. *Id.* Finally, it is Verizon that controls how an access request is provisioned when both fiber and copper are available. Yet no data is provided as to whether in those cases its affiliate is more likely to receive fiber while unaffiliated carriers are more likely receive copper.[19]

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[17] *Id.* A:72.

[18] *See* Attachment 2 hereto at 3.

[19] Indeed, the carefully crafted language used by Verizon concedes as much. Verizon asserts that its New York study shows that, "[f]or the section 272 affiliate, during 2002, 100% of the

B. Discrimination In The Provision of Goods And Services

Verizon self-disclosed here that, in addition to the pre-paid card services described above, the Section 272 affiliates (VES and GNI) provided voice mail and web maintenance services to the BOCs on a sole source basis without soliciting bids[20] in apparent violation of Section 272(c)(1).[21] The Auditor's Report also shows that Section 272 affiliates obtained preferential rates for billing and collection services[22] and local exchange services.[23]

The Auditor's Report also states that, based on the sample taken, the BOC's sales representatives failed to inform new customers of their long distance options on 9% of the calls, with 1% meeting the criteria of "steering" the customer to the Section 272 affiliate.[24] Moreover,

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requested special access circuits *were requested* on routes where Verizon BOC/ILEC provisioned DS1 circuits over fiber end to end. For the major unaffiliated carrier studied, the locations of the circuits *resulted in* 42% of the DS1 circuits using copper loops." Appendix A:73 (emphasis added). That is, although the unaffiliated carrier may have, like the 272 affiliate, *requested* fiber, that request "*resulted in*" the unaffiliated carrier being provisioned with circuits using copper loops. The BOC controls what type of access facility will be provided in response to a request, *i.e.,* whether the unaffiliated carrier will get fiber or copper.

[20] Objective VII, Procedure 1, Appendix A:55. The voice mail and web maintenance violations involved Verizon Advanced Data Inc. ("VADI").

[21] Under Section 272(c)(1), BOCs cannot discriminate in the "provision . . . of goods, services, facilities and information."

[22] Objective VII, Procedure 1, Appendix A:56 to A:57, Table 20. The price per bill was $0.96 for the unaffiliated purchase samples as compared to $0.90 (under Amendment 1) and $0.85 (under Amendment 2) for VLD; the Manual Adjustment Charge was $10 for the unaffiliated entity as compared to $5 for both VLD and VES, and the monthly minimum charge was $4,666.20 for the unaffiliated entity as compared to $4,000 for both VLD and VES.

[23] *Id.* A:59-60, Table 21. The Section 272 affiliate obtained preferential rates for a "Non-Published Service," for "Pipe with 23B+D," at least one of the rates for "Dial Tone Line" and "Federal Universal Service Fund Surcharge, Multi Line." *See also*, Appendix B-1:8 and Table 37 (CICI and TCI purchases of local exchange service from Verizon BOCs).

[24] Objective VII, Procedure 5, Appendix A:60-62 and Table 24. The "steered" customer was told that "[i]f you choose Verizon, there is no extra charge, but if you choose another carrier, there is a one-time fee of $5.00." In fact, there is no such fee. Verizon's notes of the three

the sample likely understates the occurrence of violations because of the conditions under which it was conducted. Specifically, a Verizon representative sat in on every call monitored by the Auditor.[25] The sales representative must have been aware that he or she was being audited and aware of repercussions if a violation. Such constraints are not present on a daily basis – to the contrary, pressures to sign up long distance customers for the Section 272 affiliate are likely to have the effect of increasing non-compliance. Moreover, Verizon keeps an ongoing log of violations,[26] yet the Auditor did not ask to see that log to ascertain whether the sampled calls fairly represented the frequency or nature of the violations.

C. Verizon Failed To Maintain Required Data To Verify Compliance With The Other Non-Discrimination Obligations

Section 272 requires that BOCs not discriminate with respect to the provision of facilities, services, or information concerning exchange access (§ 272(e)(2)); the amount charged or imputed for access to telephone exchange and exchange access (§ 272(e)(3)); and the provision of interLATA or intraLATA facilities or services (§ 272(e)(4)). All of these provisions were intended to prevent a BOC from using "its control of local exchange facilities to discriminate against its affiliate's rivals," and thereby, to ensure that "unaffiliated entities receive the same treatment as the BOC gives to its section 272 affiliate." *Non-Accounting Safeguards Order* ¶¶ 194, 204; *see id.* ¶ 206 (BOCs should "provide efficient service to rivals of its section 272 affiliate," and that the Commission's rules therefore "require[] that potential competitors do

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conversations it disputes are self-serving and should be rejected to the extent they conflict with the Auditor's notes of the same conversations.

[25] Attachment E:12.

[26] *Id.* E:13.

not receive less favorable prices or terms, or less advantageous services from the BOC that its separate affiliate").

As in the prior audit, Verizon often failed to maintain the data required under the *General Standard Procedures* to ascertain compliance. Thus, the Auditor could not verify compliance with § 272(e)(2) because the Auditor could not compare the 20 sampled invoices with the general ledger because "the amount recorded in the Verizon BOC/ILEC general ledger for exchange access services is an aggregate amount entered in batches and not on a per-invoice basis."[27] Nor could the Auditor compare at least one invoice to the Electronic Funds transfer because Verizon "did not provide the related amount paid."[28]

Similarly, compliance with the imputation obligation of § 272(e)(3) could not be verified for one of the four services tested either because the data from the sample used could not be matched by journal entries by state or because Verizon had not made journal entries for the sample month. Similarly, for a second service (*i.e.*, local exchange access) Verizon "was unable to provide the amount of revenue reflected in the Verizon BOC/ILEC books for local exchange services provided to the Section 272 affiliates."[29]

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[27] Objective IX, Procedure 3, Appendix A:84 (exchange access service). *Compare General Standard Procedures* at 52. This same problem infects the analysis of compliance with § 272(e)(4). *See also* Objective XI, Procedure 3, Appendix A:88 (Wholesale National Directory Assistance), and Objective X, Procedure 3, Appendix B-1:11 (local exchange service).

[28] Appendix A:84

[29] *Id.* A:87. There was also an excess $9 million difference between the amount of revenue reflected in the Verizon BOC/ILEC's books for exchange access services and the amount paid by the Section 272 affiliates (VLD, GNI and VSSI). *Id.*

II. DEFICIENCIES IN THE GENERAL STANDARDS AND PROCEDURES AND THE AUDITOR'S REPORT PERMIT ONLY SELF-REPORTED VIOLATIONS OF THE STRUCTURAL SAFEGUARDS TO BE IDENTIFIED

A. The Audit Is Utterly Incapable Of Detecting Violations Of The "Operate Independently" Safeguards, Other Than Those To Which Verizon Is Willing To Admit.

In the *OI&M Forbearance Proceedings*, and again in the *Operate Independently NPRM* proceedings, Verizon, like the other BOCs,[30] has repeatedly argued that the Section 272 audit is an adequate substitute for the Section 272(b)(1) OI&M and joint ownership safeguards.[31] This audit demonstrates the absurdity of that argument, even when dealing with structurally separate entities.

The Auditor's Report identified two OI&M violations involving the repair of Telus Communications Inc, ("TCI," a 272 affiliate in Canada) plug-in cards by a non-272 affiliate (Verizon Logistics) using Verizon California (a BOC) testing equipment and the repair of Verizon Florida (a BOC) plug-in cards by TCI.[32] Verizon sought to minimize these violations by

[30] Verizon OI&M Forbearance Petition, CC Docket No. 96-149 (Aug. 5, 2002) at 9; *Ex parte* Letter of Dee May, Verizon, to Marlene Dortch, FCC, June 4, 2003, CC Docket No. 96-149, ("Verizon's June 4 OI&M *ex parte*") at 3; Comments of Verizon, WC Docket No. 03-228 (Dec. 10, 2003) at 12 and note 16; *See also,* Comments of BellSouth, WC Docket No. 03-228 (Dec. 10, 2003) at 11; Comments of Qwest, WC Docket No. 03-228 (Dec. 10, 2003) at 7-8 and Reply Comments (Dec. 22, 2003) at 11.

[31] Section 272(b)(1) requires the interLATA affiliate to "operate independently from the Bell Operating Company." 47 U.S.C. § 272(b)(1). The Commission has explained that this requirement encompasses four important restrictions: (1) no joint ownership of switching and transmission equipment; (2) no joint ownership of land and buildings housing such facilities; (3) no provision of operations, installation and management ("OI&M") services by the BOC to the affiliate; and (4) no provision of OI&M by the affiliate to the BOC. *See* First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd. 21905 (1996) ("*Non-Accounting Safeguards Order*") ¶ 163; Memorandum Opinion and Order, Application by Bell Atlantic-New York For Authorization Under Section 271 In The State Of New York, 15 FCC Rcd. 3953, ¶ 406 (1999) ("*BA-NY Order*").

[32] Objective I, Procedure 3, Appendix B:2.

asserting that its classification of these equipment repair arrangements as "potential OI&M transactions" was "conservative."[33] However, these transactions clearly would have fallen with the OI&M cost categories Verizon identified in the *OI&M Forbearance Proceeding*.[34] Verizon will apparently define OI&M services expansively to claim that compliance with the safeguards is costly,[35] while defining them narrowly when a Section 272(b)(1) violation is identified.[36]

Deficiencies in the Auditor's Report make it impossible to ascertain whether other violations of section 272(b)(1) occurred. Because the Auditor's Report does not disclose the identity of the "third party vendors" providing OI&M services, there is no basis for determining whether the unidentified "third party contractors" may have direct, or indirect, affiliation with the BOC. Moreover, the Auditor's Report is even less informative than the first Section 272 Biennial audit report in identifying the specific services provided by these "third parties." In the first report, the Auditor at least identified categories of services (albeit undefined) such as "Technical Services" or "Telecommunications Services."[37]

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[33] Attachment E:14. These violations were also allegedly cured by reducing them to writing and/or posting these arrangements on the web. Appendix B:3 and B-1:3 and B-1:4, *but see* the *General Standard Procedures* at 36 (OI&M services cannot be provided by BOC and 272 affiliate to each other; *other* in-house services can be provided but must be provided on an arms-length basis and in writing).

[34] Verizon's June 4 OI&M *ex parte*, Attachment 3 at 5 (OI&M includes "the day-to-day provisioning and maintenance of" switching equipment).

[35] *See also* SBC's Petition for Forbearance and Modification at 6-8 (using a "broad" definition of OI&M services).

[36] Verizon declined to define OI&M services for the Auditor, stating that "Verizon's instructions for compliance with this requirement rely on the common meaning of the words in the FCC's rules." Objective I, Procedure 3, Appendix A:2 and Appendix B:2.

[37] *Compare* Report of PricewaterhouseCoopers LLP filed on June 11, 2001 and supplemented by a filing on June 18, 2001 ("Verizon's First Biennial Report"), Appendix A, Objective 1, Procedure 4.

In reviewing the joint ownership prohibition, the Auditor noted the transfer of plug-in equipment from TCI to Verizon Florida.[38] The Auditor further found that 7% of sampled assets were not properly billed to the Section 272 affiliates.[39] As to the majority of these improperly billed assets, Verizon indicated that they were reclassified as non-switching and non-transmission assets but proffered no basis for that reclassification.[40]

And, as in the first Section 272 Audit, the Auditor also found persistent and material variations between the general ledger and the detailed list of assets, making it impossible to determine whether costs are being properly allocated.[41] For three Section 272 affiliates (VLD, GNI and GSI),[42] the list of fixed assets was incomplete because that list excluded "construction in progress" ("CIP") – *i.e.*, assets not yet placed in service.[43] Verizon, in the first Biennial Audit proceeding, argued that CIP data should not be included in the itemized lists "because there would be incomplete data concerning the 'description and location of each item, date of purchase

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[38] Appendix B:2 to B:3. This would also be a violation of Section 272(c)(1), *see* Appendix B-1:7 and, to the extent provided before the execution of a written agreement, *see* Appendix B-1:3, a violation of Section 272(b)(5).

[39] Objective I, Procedure 5, Appendix A:4.

[40] *Id.*

[41] *Id.* A:3.

[42] As disclosed in the Verizon Forbearance Petition proceeding, Bell Atlantic Communications, Inc. (BACI) d/b/a Verizon Long Distance (VLD) "[p]rovides long distance service to residential customers" and "serves general business customers not served by the former Bell Atlantic local exchange carriers." Global Network Inc. (GNI) "owns and operates the Verizon domestic long distance network" and "serves only internal Verizon affiliates." Verizon Global Solutions, Inc. (GSI) "owns long distance switches in New York and Los Angeles for the primary purpose of aggregating traffic of Verizon and other carriers destined for locations outside the United States and also for the purpose of terminating traffic of foreign carriers in the United States." Verizon's June 4 OI&M *ex parte*, Attachment 1.

[43] The inclusion of VLD is odd since Verizon has represented elsewhere that VLD "does not own switching or transmission equipment." *Id.*

or transfer, price paid and recorded, and from whom the asset was purchased or transferred."[44] But disclosure of this incomplete data would be more informative than the non-disclosure that has now occurred in both audits.

Other discrepancies include the *under*statement in the list of fixed assets of over $3 million for GNI (capitalized software) and $1.5 million for VSSI,[45] and the *over*statement in the list of fixed assets for GSI by over $19 million.[46] The assets are never identified. Thus, it is unclear whether, for example, the unlisted capitalized software refers to the OSS systems GNI proposes to share with its Section 272 affiliate if the OI&M safeguard is removed.[47] Nor do Verizon's vague explanations for these over- and under-statements provide any basis for determining whether there has been a proper allocation of costs.[48]

Finally, the Auditor's sampling of assets was not conducted in the manner called for by the *General Standard Procedures.* Verizon provided the Auditor with "invoices" rather than the required title documents for transmission and switching facilities.[49]

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[44] *Ex Parte* Letter from Gerald Asch, Verizon, to Marlene H. Dortch, FCC, CC Docket No. 96-150 (June 11, 2002) at 19.

[45] Verizon Select Services, Inc. (VSSI) "serves enterprise large business customers in the areas of interexchange telecommunications services, managed voice and data solutions, and CPE" and "[p]rovides prepaid and postpaid long distance calling cards, operator services and coin long distance services nationwide." Verizon's June 4 OI&M *ex parte*, Attachment 1.

[46] Objective I, Procedure 5, Appendix A:3.

[47] *Ex parte* Letter of Anne Berkowitz, Verizon, to Marlene Dortch, FCC, October 27, 2003, CC Docket No. 96-149, at 4 (Verizon will be using enhancements to the local exchange carrier's OSSs to provide OI&M services to the section 272 affiliate.)

[48] Verizon refers to unidentified "vendor credits" or "certain credit amounts and write offs" Appendix A:3, the latter then further explained as a classification issue, Attachment E:1.

[49] *General Standard Procedures* at 28, Objective 1, Procedure 5.

B. The Elimination of Procedures Used In The Prior Audit Makes It Even More Difficult to Determine Whether There Has Been A Violation of the Other Structural Safeguards, Although Even The Limited Data Reported Suggest That There Have Been Violations

1. The Separate Books, Records, And Accounts Requirement

The Auditor's Report stated that two leases between VSSI and Verizon Credit Inc. "were not properly recorded as capital leases"[50] in violation of Section 272(b)(2)'s separate books, records, and accounts requirement.[51] Moreover, the *General Standard Procedures* used in the second audit did not require the production and review of underlying documentation, such as collections from the sale of trade accounts receivables from the 272 affiliate to the affiliates.[52]

[50] Objective II, Procedure 2, Appendix A:5. Verizon's explanation was that despite several years of experience with this requirement, "the accounting for lease transactions was performed at remote locations and not by the centralized accounting staff" and that "Verizon has instituted new procedures to strengthen internal accounting controls" and that "effective immediately the central accounting staff" will perform the "capital lease test." Attachment E:1. The Auditor also found that the Virginia Section 272 affiliates, Verizon Long Distance, Virginia Inc. ("VLD-VA"); Verizon Enterprise Solutions, Virginia Inc. ("VES-VA"); Global Networks, Virginia Inc. ("GNI-VA") and Verizon Select Services, Inc., Virginia Inc. ("VSSI-VA"), did not maintain separate books and records although they were listed as parties on certain contracts. Appendix A:1.

[51] Section 272(b)(2) requires an interLATA affiliate to "maintain books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained by the Bell Operating Company of which it is an affiliate." 47 U.S.C. § 272(b)(2).

[52] Nor did the *General Standard Procedures* require a review of the process for how the 272 affiliate received credit for these collections and verification that collection of the trade accounts receivable was reflected in the accounts of the 272 affiliate. *See* Verizon's First Biennial Report's *General Standard Procedures*, Objective II, Procedure 3.

2. The Separate Officers, Directors, And Employees Requirement

The Auditor's Report suggests potentially conflicting overlaps, but the further diluted *General Standard Procedures* preclude any ability to determine whether there has been any compliance with the "separate officers, directors, and employees" requirement.[53]

Potential violations were clearly present. The Auditor noted that "there were instances of common officers and directors between CANTV (the 272 affiliate) and Puerto Rico Telephone Company" but "due to the late disclosure of the item," the Auditor was unable to pursue this issue.[54] In addition, a program run by the Auditor pursuant to the *General Standard Procedures* identified an overlapping officer (also an employee of Verizon Corporate Services Corp.) and director (also an employee of Verizon Communications, Inc.) and 217 overlapping employees.[55]

The *General Standard Procedures* used in the second biennial audit did not, unlike those used in the first audit, require the Auditor to inquire as to whether the calculation of the annual bonuses for the 217 overlapping employees or the overlapping officer and director was tied to the performance of the BOC, or the combined performance of the BOC and the Section 272 affiliate,[56] although this omitted procedure was used by the Auditor in the prior audit to identify a potential violation of section 272.[57] The *General Standard Procedures* used in this audit also

[53] Section 272(b)(3) requires an interLATA affiliate to "have separate officers, directors, and employees from the Bell Operating Company of which it is an affiliate." 47 U.S.C. § 272(b)(3).

[54] Appendix B:3.

[55] Objective III, Procedures 1 (officers and directors) and 2 (employees). Appendix A:6. The Auditor did not, as it had in the first audit, review the Consents of the Section 272 Affiliates and the Minutes of the BOC Boards of Directors meeting to identify overlapping officers and directors (at least one potential violation was found in the prior audit). Verizon's First Biennial Report, Appendix A, Objective III, Procedure 2.

[56] Verizon's First Biennial Audit, *General Standard Procedures*, Objective III, Procedure 7.

[57] Verizon's First Biennial Report, Appendix A, Objective III, Procedure 7.

did not, unlike those used in the first audit, require the auditor to obtain and review the BOC's and Section 272 affiliates' relevant employment policies and procedures.[58] This further dilution of the *General Standard Procedures* requirements makes it impossible to ascertain whether there has been any other violation of Section 272(b)(3).

3. The No Recourse To BOC's Assets Requirement

The Auditor's Report indicates that the Section 272 affiliates' debt agreements/instruments were with a related party, Verizon Global Funding ("VGF").[59] While the Auditor "did not note any language" in those 272 affiliates' debt agreements/instruments "indicating guarantees of recourse to the Verizon BOC/ILEC's assets, either directly or indirectly through another affiliate,"[60] there is no indication that the Auditor in any way examined whether VGF's creditors had recourse to the Verizon BOC/ILEC's assets. If they did, the Section 272 affiliates would directly benefit from VGF's ability to obtain lower rates in the financial markets because its creditors had recourse to the Verizon BOC/ILEC's local monopoly assets. This is particularly true if the Section 272 affiliates are VGF's sole, or primary, borrowers. Under those circumstances, if the Section 272 affiliates defaulted, VGF would have to default on its obligations as well, and resort by VGF's creditors to the BOC assets under these circumstances would violate Section 272(b)(4).[61] In the *Non-Accounting Safeguards Order*, the Commission interpreted Section 272(b)(4) to prohibit a BOC, the parent of a BOC, or a non-Section 272 affiliate of a BOC from co-signing a contract or other instrument with its Section

[58] Verizon's First Biennial Audit, *General Standard Procedures*, Objective III, Procedure 1.

[59] Objective IV, Procedure 1, Appendix A:7.

[60] *Id.*

[61] Section 272(b)(4) provides that an interLATA affiliate "may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company." 47 U.S.C. § 272(b)(4); 47 C.F.R. § 53.203(d).

272 affiliate that would permit a creditor recourse to the BOC's assets in the events of default by the Section 272 affiliate. 11 FCC Rcd at 21995.

Moreover, when the Auditor sought confirmation of lack of recourse, less than half of the loan institutions and lessors (17/35) responded. Moreover, although the *General Standard Procedures* also required that confirmations to be sent to major suppliers and that non-major suppliers be included in the sample,[62] none of the suppliers were contacted.

III. THE AUDIT REPORT IDENTIFIES NUMEROUS VIOLATIONS OF THE TRANSACTIONAL SAFEGUARDS

A. "Transactions On An Arms' Length Basis."

Section 272(b)(5) requires an interLATA affiliate to "conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection." 47 U.S.C. § 272(b)(5). The Commission has found that these requirements include three distinct obligations: (1) the interLATA affiliate must provide, at a minimum, a detailed written description of assets transferred or services provided, and post the terms and conditions of the transaction on the company's home page on the Internet within 10 days of the transaction; (2) the descriptions "should be sufficiently detailed to allow [the Commission] to evaluate compliance with [the Commission's] accounting rules"; and (3) the descriptions must be made available for public inspection at the BOC's principal place of business, and must include a statement certifying the truth and accuracy of such disclosures.[63]

[62] *General Standard Procedures*, Objective IV, Procedure 3.

[63] Report and Order, *Accounting Safeguards Under the Telecommunications Act of 1996*, 11 FCC Rcd. 17359 (1996) ("*Accounting Safeguards Order*") at 17593-94. Specifically, disclosures should include a description of the rates, terms and conditions of all transactions, as well as the frequency of recurring transactions and the approximate date of completed transactions. For asset transfers, the BOC should disclose the appropriate quantity and, if

1. Provision Of Services Prior To The Execution Of A Written Agreement

The Auditor's Report identified nine instances disclosed by Verizon where, during the audit period, the Verizon BOCs provisioned services prior to the execution of a written agreement or amendment.[64] Six additional incidents involved the former GTE BOCs.[65]

At least five of the arrangements involved VSSI. VSSI's prepaid card arrangement with the BOCs was never fully reduced to writing.[66] Verizon claimed that its failure to do so was "inadvertent."[67] The provision of CARE products by the GTE ILECs to VSSI was also not reduced to a written agreement for almost two years, and even then, the written agreement was not complete – a supplemental written agreement had to be executed four months later.[68] This

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relevant, the quality of the transferred assets. For the affiliate transactions involving services, the BOC should disclose the number and type of personnel assigned to the project, the level of expertise of such personnel, any special equipment used to provide the service, the length of time required to complete the transaction, whether the hourly rate is a fully loaded rate, and whether or not that rate includes the cost of materials and all direct or indirect miscellaneous and overhead costs. *Second BellSouth Louisiana Order*, 13 FCC Rcd at 20790-95.

[64] Objective V and VI, Procedure 4, Appendix A:28-31.

[65] Appendix B-1:2 to B-1:4.

[66] Appendix A:30. The Auditor's Report discloses here the agreement (and amendments thereto) pursuant to which VSSI provided long distance services to the Verizon BOC/ILECs omitted the rate schedule for prepaid calling cards for an initial nine-month period and then "from January 25, 2002 forward." Moreover, "although these cards were provided to Verizon BOC/ILECs during the engagement period, the Verizon BOC/ILECs were not added as parties to the Agreement until June 21, 2002." It is unclear from the Auditor's Report as to whether this is the same prepaid card arrangement between these parties referred to in Objective VII, Procedure 1, Appendix A:55 (identified as a discriminatory no-bid sole-source arrangement).

[67] Appendix A:30; see also Attachment E:2. No explanation was provided for the preferential arrangement. Attachment E:11.

[68] Appendix A:29-30.

error was similarly attributed to "human error."[69] Other VSSI-related violations include an agreement involving "Verizon New York's supervision of two project managers in VSSI who provided management services to the Verizon West ILECs in connection with large business accounts" where services were provided for *twenty one months* before the written agreement was executed. Similarly, various carrier identification codes for VSSI were not included in an Affiliate Billing Services Agreement. No explanation is provided for the delay in reducing these agreements to writing.[70]

Verizon also omitted for eight months the rates for fraud management services under a Billing Services Agreement between the 272 affiliates and the Verizon BOCs, explained by Verizon as resulting from "inadvertence."[71] A further agreement not reduced to writing was an Operations Readiness Testing ("ORT") Services agreement with services to be provided by VLD "and/or" VES[72] for the Verizon LECs in connection with the LEC retail marketing campaigns and a nationwide network build out plan, for a contract price of approximately $3 million combined. No explanation was provided by Verizon.[73] These are not immaterial agreements, nor is the delay in reducing these agreements to writing.

The six GTE violations include the three Section 272(b)(1) violations between TCI and Verizon Florida and Verizon California. They also included TCI obtaining NOC services from

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[69] Attachment E:2.

[70] The fifth agreement was a Master Service Agreement for Ancillary Tasks. Appendix A:30.

[71] *Id.* A:30; *see also* Attachment E:2.

[72] NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions (VES) "[s]erves general business customers, primarily within the former Bell Atlantic footprint." Verizon's June 4 OI&M *ex parte*, Attachment 1. No explanation is provided as to why the Auditor could not determine whether it was VLD or VES.

[73] Appendix A:30-31; *see also* Attachment E:2.

the ILECs through a service bureau agreement, TCI's provision of training services to Verizon Hawaii and Verizon South (North Carolina), and TCI's purchase of tariffed local telecommunications services from Verizon New Hampshire, Verizon New York, Verizon Maryland, and Verizon New Jersey.[74]

2. Internet Posting Violations

The Auditor's Report identified numerous potential Internet posting violations in 35 of the 81 contracts sampled. These included a failure to state terms and/or rates in six amendments to a Marketing and Sales Agreement and a CARE product agreement with VES,[75] explained by Verizon as allegedly due "to administrative *or* human error."[76] These violations also include a failure to state rates, and in most cases also terms, from nine other agreements with GNI and VSSI.[77] As to six of these agreements, Verizon again blames alleged "human administrative error or oversight" or a "simpl[e] ... fail[ure] to map each and every rate perfectly."[78] In addition, 19 posted Access Service Requests ("ASRs") with GNI (all in New York except for a single DS-1 service in Pennsylvania) "did not contain the sufficiently detailed information necessary to enable [the Auditor] to agree the specific rates, terms and conditions in the written agreements to their respective web postings."[79]

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[74] Appendix B-1:4.

[75] Appendix A:31, Table 6. A "-" is a match and "x" a discrepancy. *Id.* A:49 and Attachment E:3.

[76] Attachment E:3 (emphasis added). No explanation is provided as to the difference between the two types of error.

[77] Appendix A:31, Table 6.

[78] Attachment E:3-E:4.

[79] Appendix A:34 and Table 7.

3. Availability For Public Inspection Violations

There were also material discrepancies between the posted transactions and those available for public inspection. Using a sample of 87 agreements from four Verizon locations in different states, 21 were identified as deficient either because they were not available for public inspection during the Auditor's visit, because specific pages were missing, or because dates were missing.[80] Over half of these breaches (13) were attributed to alleged "human" or "administrative" errors.[81] Verizon's other excuses for the reported breaches (*i.e.*, that the process is manual, that very few IXCs have ever requested these agreements, and that the Auditor did not specifically ask for these documents although it is clear that the Auditor did because they were selected from a sample) do not adequately explain why the documents were unavailable for purposes of this audit.

4. Delayed Posting Violations

Verizon failed to post a significant portion of its agreements in a timely manner. Over a third (29) of the 82 agreements sampled were not posted within 10 days as required.[82] Over a quarter of those (8) were filed late because of alleged "administrative" "issues" or "errors."[83] In addition to the sampled agreements, Verizon self-reported an additional 22 agreements (or amendments to agreements) posted late due to "administrative error."[84] The audit of the GTE ILECs identified four additional late postings (out of six sampled agreements).[85]

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[80] Appendix A:35-A:42 and Tables 9-11.

[81] Attachment E:6-E:7.

[82] Appendix A:42-A:44 and Tables 12-15.

[83] *Id.* A:42, Table 12 and Attachment E:8.

[84] Appendix A:43-A:44, Table 15 and Attachment E:8.

[85] Objective V & VI, Procedure 5, Appendix B-1:4.

5. Inadequate Web Postings

Postings for nine of the sampled agreements (and over 21 amendments thereto) "did not contain some of the required disclosures for posting."[86] For example, an amendment to a VES Marketing and Sales Agreement and two VSSI contracts did not contain "the number and type of personnel assigned to the project" and the same VES amendment and one of the VSSI agreements did not set forth "the level of expertise of such personnel (including the associated rate per service unit, *e.g.*, contacts, hours, days), any equipment used to provide the service and the length of time required to complete the transaction."[87] Moreover, the VES Marketing and Sales Agreement and all the amendments thereto failed to state, as required, "whether the hourly rate is a fully-loaded rate and whether or not that rate includes the cost of materials and all direct and indirect miscellaneous and overhead costs, for goods and services provided at FDC."[88] And the posting for the VSSI Long Distance Telecommunications Services Agreement and for a VLD Memorandum of Understanding (Access Services) failed to disclose, as required, the frequency of recurring transactions, and GNI postings for access services in Pennsylvania and New York failed to state the approximate date of the completed transaction and the completion time. Once again, Verizon's explanation was that these violations were due to alleged "administrative errors."[89]

* * *

Although Verizon repeatedly shrugs off virtually all of these violations as "administrative error," the audit demonstrates that these "errors" are too frequent and pervasive to be dismissed

[86] Appendix A:44.

[87] *See* the *General Standard Procedures* at 40 and Attachment A:45-A:48, Table 16.

[88] *See* the *General Standard Procedures* at 40 and Attachment A:45-A:48, Table 16.

[89] Appendix A:44.

and indeed undermine the credibility of those assertions. Instead, the alleged excuses show that Verizon does not take seriously its compliance obligations.

Moreover, the "[r]evised web posting procedures" adopted after the last audit and described in the Auditor's Report are clearly inadequate.[90] They consist of nothing more than "incorporat[ing] previously issued contracting and pricing guidelines" and imposing upon the Section 272 Contract Administrator two new responsibilities that are so basic and self-evident that it is hard to understand why they were not adopted earlier. The Administrator will now compare web postings to final executed agreements and will notify the employee with web posting responsibilities of new agreements or amendments prior to their execution dates). In light of the pervasiveness of the alleged "administrative errors" identified just in the very limited samples taken, the new "internal controls" hardly seem sufficient to prevent future abuse.

B. "Valuation Methodology"

1. Services Provided By The BOC To The Section 272 Affiliate

The Auditor's Report indicates that the only services provided by the BOC to the Section 272 affiliate were marketing and sales services.[91] The Auditor's Report contains only the general assertion that, for 83 of the 88 transactions sampled, the "unit charges were priced at the higher of either FDC or FMV."[92] This general assertion is insufficient. As in the prior audit, the Auditor should have inquired into the calculations of FMV and FDC at the component

[90] *Id.* A:50. *See also* Appendix C:1-C:4.

[91] Objective V & VI, Procedure 8, Appendix A:50 (provided to VLD, VES and VSSI).

[92] *Id.* The Auditor's Report further noted that 4 of the 88 sampled transactions (actually 87 sampled transactions, because one of the sampled transactions was an invoice which management indicated was billed in error) were credit balance transactions and "the invoice did not contain the unit charge" needed to determine whether these services were recorded in the books of the Verizon BOC/ILEC in accordance with the affiliate transaction rules. *Id.* A:51.

level.[93] Dr. Selwyn, in the *Operate Independently NPRM* proceedings, explained in detail why the current valuation of services provided by the BOC ILEC entities to the Section 272 long distance affiliates, including "joint marketing" services, do not comply with the "arms length" requirement under the Commission's rules.[94]

2. Services Provided By The Section 272 Affiliate To The BOC

With respect to services provided by the section 272 affiliates to the BOC, the Auditor noted that "[f]or 10 of the 87 samples, management indicated they were unable to locate the corresponding amount in the Verizon BOC/ILECs' books." Appendix A:52. This included four long distance voice services, a prepaid card service and five CPE-related services. Verizon blames the problems with the long distance and CPE services on how the data files are "processed." But the process description does not explain how the error occurred.[95]

As to asset transfers, once again the *General Standard Procedures* used here did not require the production of substantiation as required in the first audit. Specifically, although there

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[93] The *General Standard Procedures* for this item were the same, *compare* the *General Standard Procedures* in Verizon's Second Biennial Audit, Objective V & VI, Procedure 6 *with* the *General Standard Procedures* in Verizon's First Biennial Audit, Objective V/VI, Procedure 9 and Verizon's First Biennial Report, Appendix A, Objectives V/VI, Procedure 9, at 20-24 (for approximately 70 percent of the transactions, the Auditor was unable to compare all of the components of FDC and FMV, including development and maintenance of customer database records and the customer complaint center). The remedial steps described in Appendix C:12 – C:13 do not, and clearly should not, include eliminating this analysis entirely.

[94] AT&T's Operate Independently NPRM Comments, WC Docket No. 03-228, Selwyn Dec. ¶ 27 (filed December 10, 2003). *See also* Dr. Selwyn's discussion of the "prevailing price loophole," Selwyn Dec. ¶¶ 9, 29-30. That loophole seems to have been used here as well. *See e.g.*, Appendix B-1:5 (for Directory Assistance provided by TCI to the BOCs).

[95] TCI also provided the Verizon BOC/ILECs with Directory Assistance priced at Prevailing Market Price ("PMP"). Appendix B-1:5. The basis for valuation at PMP rather than the lower of FMV or FDC, *see* the *General Standard Procedures* at 35, is not provided.

were inter-affiliate asset transfers, management was not required to produce to the Auditor the underlying invoices to confirm that the assets transferred to the Section 272 affiliates were not "indirect" transfers from the BOC through another affiliate.[96]

CONCLUSION

For the reasons stated, the Commission should penalize Verizon for its lack of compliance with Section 272, and should immediately re-audit Verizon using appropriate procedures and standards.

Respectfully submitted,

/s/ Aryeh S. Friedman

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February 10, 2004

[96] Verizon's First Biennial Report, Appendix A, Objective V &VI, Procedure 13.

Attachment 1

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	**EB Docket No. 03-200**
Section 272(d) Biennial Audit of Verizon Communications, Inc.	)	
	)	

DECLARATION OF ROBERT M. BELL
ON BEHALF OF AT&T CORP.

1. My name is Robert M. Bell. My business address is AT&T Labs-Research, 180 Park Avenue, Florham Park, New Jersey 07932.

2. I received a Ph.D. in Statistics from Stanford University in 1980. From 1980 to 1998, I was promoted to Senior Statistician at RAND, a non-profit institution that conducts public policy analysis. While at RAND, I supervised the statistical design and/or analysis of many projects, including several large multi-site evaluations. I also headed the RAND Statistics Group from 1993 to 1995 and taught statistics in the RAND Graduate School from 1992 to 1998. In 1998, I joined the Statistics Research Department at AT&T Labs-Research, where I am a Principal Member of Technical Staff. My main research area is survey research methods. I have authored or co-authored fifty articles on statistical analysis that have appeared in a variety of refereed, professional journals. I am a fellow of the American Statistical Association. I am currently a member of the Committee on National Statistics organized by the National Academy of Sciences as well as the Academy's Panel to Review the 2000 Census. I have attached a copy of my curriculum vitae as Exhibit RMB-1.

3. I submitted a Declaration in the first Verizon Section 272 Audit proceeding, CC Docket No. 96-150, on April 8, 2002 and a Declaration in the first SBC Audit proceeding, CC Docket No. 96-150, on January 29, 2002.

4. The purpose of this declaration is to address the data on performance measurements in Attachment A as well as the studies relied upon by Verizon to justify the differentials shown by that data described in Appendix A:68-A:75.

I. THE PERFORMANCE MEASUREMENT DATA SHOWS THAT VERIZON HAS DISCRIMINATED IN FAVOR OF ITS SECTION 272 AFFILIATE.

5. The data in Attachment A show consistent and material discrimination in favor of the 272 affiliate over unaffiliated carriers for DS-1 service in New York and Massachusetts.

6. The average Firm Order Confirmation Response Time ("FOC") intervals for non-affiliated carriers were consistently and materially longer than for the 272 affiliate. Although it can be difficult to extrapolate from single month comparisons due to small sample sizes of affiliate orders, the monthly data show striking consistency. In New York, the non-affiliate average was longer in 21 of the 23 months where there were any affiliate orders (including one tie), usually by a factor of three or greater (Attachment A, pp. A-35 and A-36). In Massachusetts, the non-affiliate average was greater in each of the 12 months where there were affiliate orders (pp. A-15 and A-16).

7. Year long comparisons confirm that non-affiliates received far poorer service. For 2001 in New York, the average FOC interval for non-affiliates was 7.5 days (with

an estimated standard error ("SE") of 0.08)[1] versus only 2.1 days for section 272 affiliates (SE = 0.32). For 2002, averages were 3.3 days (SE = 0.03) versus 1.5 days (SE = 0.29). In Massachusetts, the averages were 7.9 days (SE = 0.15) versus 2.0 days (SE = 0.48) for 2001 and 1.6 days (SE = 0.02) versus 1.1 days (SE = 0.13) for 2002.

8. Results for "Average Installation Interval" followed a similar pattern for these two states. For New York, non-affiliates received poorer service in 22 of 23 comparisons (pp. A-37 and A-39). In 2001, the non-affiliates' average was 28.4 days (SE = 0.17) versus only 17.1 days (SE = 2.05) for affiliates. In 2002, the averages were 26.6 days (SE = 0.15) and 15.4 days (SE = 1.89), respectively.

9. For Massachusetts, the non-affiliate averages were longer in 7 of the 8 months where there were any affiliate orders (pp. A-17 and A-19). In 2001, the non-affiliates' average was more than twice that for affiliates: 33.4 days (SE = 0.36) versus 14.6 days (SE = 2.56). In 2002, the averages were 24.8 days (SE = 0.19) and 18.7 days (SE = 1.53), respectively.

10. Similarly, non-affiliates in New York and Massachusetts consistently received poorer service in terms of average repair times. In New York, non-affiliates had longer repair times for DS1 service in 21 of 23 comparisons (pp. A-41 and A-42).[2] For FG-D in Massachusetts, non-affiliates had longer repair times for 11 of 12 months in 2002 (no data were reported for this product in 2001, p. A-22). The non-affiliates' average was more than twice that

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[1] Discussed in my Declaration in the first Verizon Section 272 Audit proceeding, CC Docket No. 96-150 (April 8, 2002) at ¶ 41.

[2] From the extremely large standard deviations reported for DS1, it is clear that there is at least one outlier (very large repair time) in October 2001 (for non-affiliates) and in December 2002 (for affiliates). Consequently, reporting averages based on all 12 months would be misleading. Calculations based on the other 11 months for each year yield the following results. In 2001, the non-affiliates' average was 6.3 days (SE = 0.17) versus 5.2 days (SE = 1.37) for affiliates. In 2002, the averages were 6.9 (SE = 0.06) and 3.5 days (SE = 0.63), respectively.

for section 272 affiliates: 3.0 days (SE = 0.21) versus 1.4 days (SE = 0.11). Indeed, these data may well understate the true differential inasmuch as Verizon excluded "trouble" data that should have been included under the business rules Verizon used.[3]

11. The skewness (long tail) of the installation times and samples sizes make it inappropriate to try to do formal hypothesis testing without access to the raw data (*e.g.*, to allow permutation testing). Nonetheless, comparisons of the non-affiliate/affiliate differences with the estimated standard errors for the individual averages make it clear that none of the differences in the preceding paragraphs were likely to have occurred by chance if installation/repair times for the two sets of customers were drawn from the same distribution.

II. THE STUDIES RELIED UPON TO JUSTIFY THESE DIFFERENTIALS ARE INCOMPLETE AND THEY DO NOT EXPLAIN THE OBSERVED DIFFERENTIALS.

12. Verizon suggests a variety of theories to explain inferior service performance for DS1 (Appendix A:71-75). In each case, it argues that non-affiliate orders differed systematically from those of section 272 affiliates in a way that made them harder to process and would therefore have led to longer installation or repair times in the absence of discrimination. Verizon then leaves it to the reader to infer that the referenced differences in order characteristics completely explain the differential in service times.

13. However, the Verizon analyses are generally superficial and incomplete, omitting, for example, "like-to-like" comparisons that would shed light on whether Verizon handles comparable orders in a nondiscriminatory manner. In addition, each analysis is based on a limited set of months and states, with little justification for the choices made. For example, the lone reported like-to-like comparison is for a single month-state combination, July 2002 in New

[3] Appendix A:77.

York (Appendix A:72). There is no way to know whether other comparisons might have come out very differently had data from other months/states been analyzed as well. Indeed, because this analysis was not performed by an independent auditor, we cannot be sure that other, conflicting results have not been suppressed.

A. Installation

14. Verizon presents data for July 2002 in two states showing that unaffiliated carriers requested due dates beyond the standard minimum provisioning date more frequently than the section 272 affiliates did. Furthermore, it states that Verizon adjusts provisioning delivery in response to the due dates requested by customers. These finding establish the two elements necessary to show that a simple comparison of overall average installation times for non-affiliates and affiliates may be biased by customer request date differences.

15. However, without empirical evidence about the size of the delay associated with requested due dates beyond the standard minimum, Verizon's analysis provides no evidence that this factor explains a substantial portion – much less all – of the large difference between the average installation times for non-affiliates versus affiliates. This question could have been addressed directly by comparing non-affiliate installation times with those for affiliates, restricted to orders where the customer did not request an extension to the due date. Inexplicably, Verizon failed to present results of that analysis even though the necessary data were demonstrably available once it had identified which orders had extended customer requested due dates.

B. Installation and Repair

16. Similarly, Verizon offered fiber versus copper as a partial explanation for the differential in average installation interval as well as the sole explanation for the differential in repair interval, but again failed to complete the analysis (Appendix A:73-75). First, it simply

asserted that provisioning and repair over copper lines take more time, without giving any empirical data on how much longer either activity takes. Second, Verizon again failed to analyze and report "like-to-like" comparisons. For example, because all special access installation requests by affiliates in 2002 were over fiber, it would have made sense to compare the average installation interval for affiliates to that for non-affiliate orders restricted to fiber. Verizon failed to do so. Consequently, there is no basis for assuming that fiber versus copper explains more than a trivial portion of either the differentials in average installation interval or those in repair times.

C. The Studies Provide No Credible Evidence Regarding The Magnitude Of The Impact Of The Claimed Causes

17. Given the deficiencies of its analyses, Verizon failed to provide credible evidence regarding how much of the observed differentials any particular claimed characteristic might explain. Furthermore, even to the extent that individual characteristics may explain fractions of the differentials for average installation interval, those effects would not be additive to the extent that orders with one of the characteristics are more likely to have one of the others (e.g., both copper lines and need for facility building). Consequently, Verizon has not demonstrated that the longer service times received by non-affiliates were due to differences in the characteristics of the orders.

Robert Bell

Robert M. Bell

Dated: this 9TH day of FEBRUARY, 2004

Exhibit RMB-1

ROBERT M. BELL

EDUCATION

Ph.D., Statistics, 1980, Stanford University

M.S., Statistics, 1973, University of Chicago

B.S., Mathematics, 1972, Harvey Mudd College

PROFESSIONAL EXPERIENCE

1998-Present – Principal Member Technical Staff, Statistics Research Department, AT&T Labs - Research, Florham Park, NJ; 2003 AT&T Science and Technology Medal

1991-1999 -- Senior Statistician, RAND, Santa Monica, California; Head, RAND Statistics Group (1993-1995); Member, RAND Graduate School Faculty (1991-1998)

1988-1991 -- Statistician, Social Policy Department, RAND, Santa Monica, California

1980-1988 -- Associate Statistician, Economics and Statistics Department, RAND, Santa Monica, California

1975-1979 -- Teaching Assistant/Research Assistant, Department of Statistics, Stanford University

1973-1975 -- Consultant and Mathematical Assistant, Economics Department, The RAND Corporation, (also intermittently during educational leave)

RESEARCH AREAS

Experimental Design and Survey Development. Dr. Bell supervised statistical design of Project Alert, an experiment of drug abuse prevention in thirty California and Oregon junior high schools. This work has involved data collection and analysis for sample selection/assignment, development of a series of 30 page questionnaires, and design of sampling procedures for several secondary analyses.

Data Analysis. Dr. Bell supervised the main data analysis in Project ALERT. He previously supervised analysis of clinical data from the National Preventive Dentistry Demonstration Program, a study of school-based preventive treatments. Data from that study included one to five annual examinations of 30,000 children in 10 communities, over 10,000 replicate examinations, and 20,000 surveys.

Statistical Methodology. Dr. Bell's methodological interests include survey research methods, analysis of data from complex samples, record linkage methods, analysis of missing data, measurement and scaling, robust procedures, empirical Bayes estimation, and sample reuse methods.

PROFESSIONAL ORGANIZATIONS/HONORS

Member, Committee on National Statistics, National Academy of Sciences, 2001-present.
Chair, Committee to Review the 2000 Decade Design of the Scientists and Engineers Statistical Data System (SESTAT), National Academy of Sciences, 2002.
Member, Panel to Review the 2000 Census, National Academy of Sciences, 1998-present.
Fellow, American Statistical Association, 1998.
Chair, American Statistical Association Subcommittee, Census Advisory Committee of Professional Associations, 1997-1998; Member, 1995-2000.
Member, Panel on Alternative Census Methodologies, National Academy of Sciences, 1995-1999.
Member, Committee on Minorities in Statistics, American Statistical Association, 1995-2000.
Member, Panel to Evaluate Alternative Census Methods, National Academy of Sciences, 1992-1994.
Visiting Lecturer for American Statistical Association, 1984-1986.
Program Chairman, Applied Statistics Workshop, Southern California Section of American Statistical Association, 1984.
Institute of Mathematical Statistics, since 1979.
American Statistical Association, since 1974.

PUBLICATIONS

Published Articles

"Bias Reduction in Standard Errors for Linear Regression with Multi-Stage Samples," *Survey Methodology*, Vol. 28, 2002, 169-181 (Bell and McCaffrey).

"School-Based Drug Prevention: Challenges in Designing and Analyzing Social Experiments," in *Public Policy and Statistics: Case Studies from RAND*, eds. S.C. Morton and J.E. Rolph, Springer-Verlag, New York, 2000.

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"Adolescent Use of Illicit Drugs Other Than Marijuana: How Important is Social Bonding ant for Which Ethnic Groups?" *Substance Use and Misuse*, Vol. 34, 1999, 317-346 (Ellickson, Collins, and Bell).

"Simultaneous Polydrug Use among Teens: Prevalence and Predictors," *Journal of Substance Use*, Vol. 10, 1999, 233-253 (Collins, Ellickson, and Bell).

"Physician Response to Prenatal Substance Exposure," *Maternal and Child Health Journal,* 1999, 29-38 (Zellman, Bell, Archie, DuPlessis, Hoube, and Miu).

"Underuse and Overuse of Diagnostic Testing for Coronary Artery Disease in Patients Presenting with New-Onset Chest Pain," *American Journal of Medicine*, 1999, 391-398, (Carlisle, Leape, Bickel, Bell, et al.).

"Underuse of Cardiac Procedures: Do Women, Ethnic Minorities, and the Uninsured Fail to Receive Needed Revascularization?," *Annals of Internal Medicine*, Vol. 130, 1999, 183-192 (Leape, Hilborne, Bell, Kamberg, and Brook).

"The Sexual Practices of Asian and Pacific Islander High School Students," *Journal of Adolescent Health*, Vol. 23, 1998, 221-231 (Schuster, Bell, Nakajima, and Kanouse).

"Does Early Drug Use Increase the Risk of Dropping out of High School?," *Journal of Drug Issues*, Vol. 28, 1998, 357-380 (Ellickson, Bui, Bell, and McGuigan).

"Impact of a High School Condom Availability Program on Sexual Attitudes and Behaviors," *Family Planning Perspectives*, Vol. 30, 1998, 67-72 & 88 (Schuster, Bell, Berry, and Kanouse).

"Analytic Versus Holistic Scoring of Science Performance Tasks," *Applied Measurement in Education*, Vol. 11, 1998, 121-137 (Klein, Stecher, Shavelson, McCaffrey, Ormseth, Bell, Comfort, and Othman).

"Influencing Physician Response to Prenatal Substance Exposure Through State Legislation and Work-Place Policies," *Addiction*, Vol. 92, 1997, 1123-1131 (Zellman, Jacobson, and Bell).

"Adjusting Cesarean Delivery Rates for Case Mix," *Health Services Research*, Vol. 32, 1997, 509-526. (Keeler, Park, Bell, Gifford, and Keesey).

"Students' Acquisition and Use of School Condoms in a High School Condom Availability Program," *Pediatrics*, Vol. 100, October 1997, 689-694 (Schuster, Bell, Berry, and Kanouse).

"Impact Of Response Options And Feedback About Response Inconsistencies On Alcohol Use Self-Reports By Microcomputer," *Journal of Alcohol and Drug Education*, Vol. 42, 1997, 1-18 (Hays, Bell, Gillogly, Hill, Giroux, Davis, Lewis, Damush, and Nicholas).

"Adjusting for Attrition in School-Based Samples: Bias, Precision, and Cost Trade-Offs of Three Methods," *Evaluation Review,* Vol. 21, October 1997, 554-567 (McGuigan, Ellickson, Hays, and Bell).

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Counting People in the Information Age, Final Report, Panel to Evaluate Alternative Census Methods, Committee on National Statistics, Division on Behavioral and Social Sciences and Education. National Academy Press, Washington, D.C., 1994.

A Census that Mirrors America, Interim Report, Panel to Evaluate Alternative Census Methods, Committee on National Statistics, Division on Behavioral and Social Sciences and Education. National Academy Press, Washington, D.C. 1993.

RAND Publications

The Sexual Practices of Asian and Pacific Islander High School Students, RP-744, RAND, 1998 (Schuster, Bell, Nakajima, and Kanouse).

Analysis of Data from Complex Surveys (videorecording), Statistics Short Course Series, V-092, RAND, 1997 (McCaffrey and Bell).

Graphical Methods for Data Analysis, (videorecording), Statistics Short Course Series, V-022 through V-025, RAND 1996 (Bell and McCaffrey).

Defining Infants' Race and Ethnicity in a Study of Very Low Birthweight Infants, MR-191-AHCPR, RAND, 1993 (Farley, Richards, and Bell).

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The Reliability of Clinical and Radiographic Examinations in the National Preventive Dentistry Demonstration Program, R-3138-RWJ, The RAND Corporation, Santa Monica, California, June 1984 (Klein, Bell, Bohannan, Disney, and Wilson).

Treatment Effects in the National Preventive Dentistry Demonstration Program, R-3072-RWJ, The RAND Corporation, Santa Monica, California, February 1984 (Bell, Klein, Bohannan, Disney, Graves, and Madison).

Outcome-Based Reimbursement for Nursing-Home Care, R-3092-NCHSR, The RAND Corporation, Santa Monica, California, December 1983 (Kane, Bell, Hosek, Riegler, and Kane).

The Military Application Process: What Happens and Can it be Improved?, R-2986-MRAL, The RAND Corporation, Santa Monica, California May 1983 (Berryman, Bell, and Lisowski).

Predicting the Course of Nursing Home Patients: A Progress Report, N-1786-NCHSR, The RAND Corporation, Santa Monica, California, January 1982 (Kane, Riegler, Bell, Potter, and Koshland).

Results of Baseline Dental Examinations in the National Preventive Dentistry Demonstration Program, R-2862-RWJ, The RAND Corporation, Santa Monica, California, April 1982 (Bell, Klein, Bohannan, Graves, and Disney).

CETA: Is it Equitable to Women?, N-1683-DOL, The RAND Corporation, Santa Monica, California, May 1981 (Berryman, Chow, and Bell).

Plan for the Analysis of Dental Examination Data in the National Preventive Dentistry Demonstration Program, N-1658-RWJ, The RAND Corporation, Santa Monica, California, April 1981 (Klein and Bell).

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February 2004

Attachment 2

BELL ATLANTIC SCHEDULE OF STANDARD MINIMUM INTERVALS

1.0 - GENERAL

The intervals listed in the following tables depict the minimum number of business days required to provide Special Access Services as specified in the FCC tariffs. These intervals will also apply to the same services provided for the corridor service. Services or quantities without specific listing in the table or jointly provided with another telephone company, will be provided with negotiated Intervals as set forth in section 5 of FCC Tariff No. 1 and FCC Tariff No. 11.

Definitions of the Provisioning Critical Dates listed in the table are as follows:

- Application Date (APP): The date the customer provides a firm commitment and a quality ASR with sufficient and accurate information on the ASR, as detailed in Section 5 of FCC Tariff No.1 and FCC Tariff No.11. This is the order date and is considered day number zero in the overall interval.

- Service Date (DD) : The date on which the service is to be made available to the customer. This is sometimes referred to as the Due Date.

STANDARD MINIMUM INTERVAL TABLE

1.10 – SPECIAL ACCESS SERVICES (See Notes)

TYPE OF SERVICE	LINES/CIRCUITS QUANTITIES	TOTAL SERVICE INTERVAL (Business Days)
Voice Grade Services	1 - 24 25+	9 Negotiated*
WATS Access Services	1 – 24 25+	9 Negotiated*
Digital Data Services	1 – 24 25+	9 Negotiated*

Note 1 - No day zero due date orders will be accepted.

Note 2 - The Date Due will be confirmed subject to an availability of necessary facilities. Where Facilities do not exist, an interval will be negotiated.

* Provided under Negotiated Interval as set forth in Section 5 of FCC Tariff No. 1 and FCC Tariff No. 11.

STANDARD MINIMUM INTERVAL TABLE

1.20 – HIGH CAPACITY SPECIAL ACCESS SERVICES (See Notes)

TYPE OF SERVICE	LINES/CIRCUITS QUANTITIES	TOTAL SERVICE INTERVAL (Business Days)
High Capacity DS1 (Includes Point to Point and Mux Systems)	1 - 8	9
	9 +	Negotiated*
High Capacity DS3 (Includes Point to Point and Mux Systems)	1 – 4	20
	5 +	Negotiated*

Note 1- No day zero due date orders will be accepted.

Note 2 - The Due Date will be confirmed subject to an availability of necessary facilities. Where Facilities do not exist, then an interval will be negotiated.

Note 3 - These intervals will include Wireless Services where the Buildings and Sites already exists. If this is a new Site and /or no Building exists, then the Site Survey Process must be followed and the interval will be negotiated.

Note 4 - The DS1 Interval includes a three (3) day facility check, this will ensure the date that is provided on the FOC will be as reliable as possible.

Note 5 – The DS3 Interval includes a five (5) day facility check, this will ensure the date that is provided on the FOC will be as reliable as possible.

Note 6 – In the near future, Bell Atlantic will be developing expedite charges that will apply for service requests less than the standard interval.

* Provided under Negotiated Interval as set forth in Section 5 of FCC Tariff No. 1 and FCC Tariff No. 11.

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of February, 2004, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: February 10, 2004

/s/ Karen Kotula
Karen Kotula

SERVICE LIST

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